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In the Supreme Court of the United States

OCTOBER TERM, 1992

NEWARK MORNING LEDGER CO.,
AS SUCCESSOR TO THE HERALD COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF AMICUS CURIAE MAGAZINE PUBLISHERS OF AMERICA, INC. IN SUPPORT OF PETITIONER

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INTEREST OF AMICUS CURIAE

Amicus Magazine Publishers of America, Inc. (MPA) is a national trade association incorporated under the laws of the State of New York. It submits this brief in support of the petitioner.[1] MPA's membership includes 235 publishing firms that publish 1,193 consumer interest magazines. MPA

[1] Written consent of the parties has been filed with the Clerk of the Supreme Court pursuant to Rule 37.

members' publications include mass-circulation weeklies, monthly home and fashion magazines, journals of opinion, non-profit publications, and a wide variety of special interest publications. These publications are the leading magazines in an industry which delivers approximately 9,000,000,000 subscription copies per year and sells approximately 2,400,000,000 single issues per year through retail outlets.

MPA members regularly acquire, collect and maintain extensive subscription and other demographic information regarding the subscribers to their publications.

In the 1980s a number of MPA members purchased magazines in asset or asset-equivalent acquisitions involving billions of dollars. In these acquisitions, it was the usual circumstance that only a small portion of the purchase price represented the value of the tangible assets acquired. Among the intangible assets acquired in almost every transaction were paid subscribers, finite groups with statistically predictable, limited useful lives and values determined using appraisal methods commonly chosen in everyday business circumstances. These acquired subscribers were not only customers, they also served as assets used in the business to attract advertising revenues. This factor is significant because in a majority of MPA member circumstances, advertising revenue is equal to or a greater portion of a magazine's revenues than is circulation revenue.

The MPA member acquisition transactions were planned and executed with the expectation, based upon decided cases and respondent's own rulings and acquiescences, that the amounts expended for the acquired subscribers would be amortizable over the limited useful life which that asset was predicted to have in the acquirer's publishing business. Contrary to its earlier pronouncements, respondent now challenges not only the applicable Code and regulatory provisions, but also the fundamental economic and tax

assumptions upon which both buyers and sellers conceived and executed their transactions.

SUMMARY OF ARGUMENT

The Third Circuit misperceived the applicable precedent and created a conflict among the circuits. It substituted a restricted definition of goodwill found in the case law for the tax law description of depreciable intangible assets and nondepreciable (residual) goodwill found in the Treasury regulations. It also completely ignored the time-honored principle that the essence of goodwill, as a tax concept, is its indeterminate life. While it relied upon *Houston Chronicle Publishing Co. v. United States*, 481 F.2d 1240 (5th Cir. 1973), cert. denied, 414 U.S. 1129 (1974), it ignored the Fifth Circuit's rejection of "the establishment of a *per se* rule and a monolithic 'mass asset' theory that would amalgamate all subscriptions lists with goodwill." *Id.* at 1253.

In its March 16, 1992 brief in this case on the petition for writ of certiorari, respondent compounded the Third Circuit's misperception by arguing erroneously that a talismanic change occurred in the Treasury regulations in 1927. The precedent upon which respondent relied in making this argument demonstrates that the new, 1927 version of the pertinent Treasury regulation included no change in the principle that has always existed in the Treasury regulations: where it can be shown that an intangible asset has a limited life and an ascertainable value depreciation is allowable.

Though the Third Circuit relied upon numerous cases for a definition of goodwill (Pet. App. at 23a-25a), it ignored the fact that in practically all these cases the court also held as a matter of law that where a taxpayer could show that it had acquired an intangible asset having a limited life and an ascertainable value, depreciation was allowable. Addition-

ally, the Third Circuit also failed to cite or rely upon the latest cases from the circuits which have considered the same issue.

Finally, the District Court provided in its "galaxy of customers" description an appropriate "bright-line" test to distinguish between a customer-based intangible asset which has a limited useful life and nondepreciable goodwill.

For these reasons, the Court should reverse the decision of the Third Circuit.

ARGUMENT

I

THE THIRD CIRCUIT HAS MISPERCEIVED THE APPLICABLE LAW AND TREASURY REGULATIONS AND HAS CREATED A CONFLICT AMONG THE CIRCUITS

A. The Essence of Goodwill as a Tax Concept is its Indeterminate Useful Life

The decision of the Third Circuit is in direct conflict with decisions in a number of the Circuits.[2] It is the result of a

[2] The relevant Circuit Court opinions are: *Houston Chronicle Publishing Co. v. United States, supra; Laird v. United States,* 556 F.2d 1224 (5th Cir. 1977), cert. denied, 434 U.S. 1014 (1978); *Super Food Services, Inc. v. United States,* 416 F.2d 1236 (7th Cir. 1969) (separate intangible assets found to exist in purchase of grocery store business; this taxpayer victory was not mentioned in *Decker v. Commissioner,* 864 F.2d 51 (7th Cir. 1988)); *Donrey, Inc. v. United States,* 809 F.2d 534 (8th Cir. 1987) (acquisition of a business, including customer based intangible assets; holding that in *General Television, Inc. v. United States,* 598 F.2d 1148 (8th Cir. 1979), it held "[e]ntitlement to a

fundamentally flawed analysis of the applicable statutory and regulatory provisions and case law.

Goodwill has been an elusive tax concept. While a number of judicial definitions of this term have been attempted, including those referring to continued patronage,[3] these definitions fall short of a proper tax analysis. Such an analysis makes clear that the essence of goodwill as a tax concept is its indeterminate useful life. Where a limited useful life can be shown for a specific intangible asset, such asset is not, for tax purposes, included in goodwill. This is evident from the plain language of the Code and respon-

depreciation allowance for an intangible asset is a question of fact." 809 F.2d at 536); *Commissioner v. Seaboard Finance Co.,* 367 F.2d 646 (9th Cir. 1966); *Citizens & Southern Corp. v. Commissioner,* 919 F.2d 1492 (11th Cir. 1990) (core deposit accounts acquired in the acquisition of a bank are depreciable); *Richard S. Miller & Sons, Inc. v. United States,* 537 F.2d 446 (Ct.Cl. 1976); see also *Panichi v. United States,* 834 F.2d 300, 302 (2d Cir. 1987) (purchase of a customer list only, and not an entire business; the Second Circuit did not hold that had the customer list been purchased with an ongoing business a different tax result—nondepreciability—would have followed).

[3] See *Boe v. Commissioner,* 307 F.2d 339, 343 (9th Cir. 1962); but see *Commissioner v. Seaboard Finance Co., supra,* holding that the result in *Boe* would have been different if the taxpayer there had carried his factual burden of valuing the individual contracts that he acquired. 377 F.2d at 652-53. See also *Los Angeles Central Animal Hospital, Inc. v. Commissioner,* 68 T.C. 269, 273-74 (1977), acq., 1978-2 C.B. 2 (holding that medical files acquired in the acquisition of an ongoing business were an intangible asset separate and distinct from goodwill and, consequently, could be depreciated). The significance of the Commissioner's acquiescence in this decision is discussed, *infra,* at Pp. 19-20.

dent's own regulations, as well as the leading precedent in the various Circuits.

In the first place, a deduction for depreciation has always been available for "property used in a trade or business."[4] Second, Congress has never made a distinction between tangible and intangible property in segregating depreciable assets from nondepreciable assets. In the case of all forms of property, the matching principle of associating income and expenses relating to the same tax period has permitted a deduction for depreciation where it has been shown that an asset has a limited and ascertainable life. *Indopco, Inc. v. United States,* 112 S. Ct. 1039, 1043 (1992); see also *Massey Motors, Inc. v. United States,* 364 U.S. 92, 104 (1960):

> . . . the primary purpose of depreciation accounting [is] to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use . . . of the asset to the periods to which it contributes.

In *Northern Natural Gas Co. v. O'Malley,* 277 F.2d 128, 140 (8th Cir. 1960), Justice Blackmun, then a member of

[4] Section 234(a)(7) of the Revenue Act of 1918 provided a deduction for depreciation as follows:

> A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

Section 167 of the Code currently provides—

> a depreciation deduction . . . for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) (1) of *property* used in a trade or business. . . . (Emphasis added.)

Similar provisions have been included in all intervening versions of the Internal Revenue Code.

the Eighth Circuit, commented that tax depreciation should "coincide with good business practice and good accounting."

In the *Newark Morning Ledger* circumstance, and other circumstances with which this amicus is familiar, the acquired paid subscribers are assets used in the trade or business not only as customers, but also as a circulation base necessary to attract revenue from advertising customers. See *Donrey, Inc.,* 809 F.2d at 536; see also Pet. App. at 6a-7a, n.2.

Just as the Congress has not made a distinction between tangible and intangible property in the Internal Revenue Code, no distinction has ever existed between tangible and intangible property in respondent's regulations. For intangible assets, Article 163 of Treasury Regulation 45, promulgated by the Treasury Department with respect to the Revenue Act of 1918 provided:

> *Depreciation of Intangible Property.* Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. *If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance,* provided the facts are fully shown in the return or prior thereto to the satisfaction of the commissioner. There can be no such allowance in respect of good will, trade-names, trade-marks, trade brands, secret formulae, or processes. (Emphasis added.)

Similarly, Treasury Regulation §1.167(a)-3, applicable in the tax period in suit, and currently, provides as follows:

> *If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance.* Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to good will. (Emphasis added.)

In each circumstance, encompassing over 70 years of the tax law, the existence, *vel non*, of a "limited" useful life for an intangible asset has served as the fulcrum between depreciability and nondepreciability.

This focus upon whether an intangible asset has a limited useful life finds parallel support in respondent's Treasury Regulation § 1.167(a)-1(a) and (b). Tangible property used in a trade or business is also depreciable over its "estimated useful life." Just as the notion of continued patronage has never mistakenly been an element in determining the depreciability of a tangible asset, its intrusion into the process of determining the depreciability of an intangible asset is also inappropriate.

B. Respondent Misperceives Treasury Decision 4055 and *Red Wing Malting Co. v. Willcuts*

Respondent erroneously contends that the Commissioner barred a deduction for depreciation of "goodwill" in its 1927 version of its Treasury regulations. *Brief for United States on Petition for a Writ of Certiorari,* at 9. In its March, 1992 Brief to this Court in this case, respondent argued that the prohibition against depreciation of goodwill was first incorporated in the Treasury regulations in 1927.[5] See T.D. 4055, VI-2 C.B. 63. Respondent misperceives Treasury Decision 4055. There, the Commissioner relied upon the decision in *Red Wing Malting Co. v. Willcuts,* 15 F.2d 626 (8th Cir. 1926), cert. denied, 273 U.S. 763 (1927), to add the following sentence to the regulations pertaining to the depreciability of intangible assets (Article 163 of Regulation 45, *supra,* at p.7):

> No deduction for depreciation, including obsolescence, is allowable in respect of good will.

This sentence replaced the last sentence of the same regulation *(Id.)*:

> There can be no such allowance in respect of good will, trade-names, trade-marks, trade brands, secret formulae or processes.

A review of these two sentences raises serious doubt about the accuracy of respondent's contention that the prohibition against depreciation of goodwill was a distinct 1927 regulatory act. In the first place, it is hard to find any difference between the two regulatory sentences quoted above.[6] Conse-

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[5] Respondent provided no limitation of its use of the term "goodwill" in its March 16, 1992 brief. In that the argument was made in the instant case, it is obvious that respondent would include petitioner's paid subscribers intangible asset within its concept of goodwill. Where respondent would draw the line on the outer limits of its position is unclear, but clearly it intends its position to be far-reaching.

[6] If anything, the list of depreciable intangible assets was enlarged by the new regulatory language. No longer was there a

quently, respondent's suggestion that there occurred a talismanic regulatory event in 1927 is more illusory than real.

Second, a close reading of *Red Wing Malting, supra,* reveals respondent's misperception. Red Wing Malting claimed a deduction for the "obsolescence or loss" of its goodwill because its liquor business had become obsolete as a result of the 18th Amendment. *Id.*, 15 F.2d at 627. Red Wing Malting argued that the phrase "including a reasonable allowance for obsolescence," included for the first time in the Revenue Act of 1918, introduced a tax deduction in addition to the allowance for "exhaustion, wear and tear" language of the depreciation statute then in effect. See § 234(a)(7) of the Revenue Act of 1918, *supra*, p. 6, n.4. The Eighth Circuit disagreed, stating (*Id.*, 15 F.2d at 630, 631):

> If it had been intended by the Congress to create a new and additional deduction not connected with property used in the business subject to 'exhaustion, wear and tear,' it would have been very easy for Congress, instead of using the word 'including,' to have said, 'a reasonable allowance for exhaustion, wear and tear and obsolescence of property used in the business.' That would have made the matter clear.
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> * * *
>
> . . . the language 'including a reasonable allowance for obsolescence' is but a part of and an enlargement of the previous phrase of the said subsection (7) relating to exhaustion, wear, and tear, and . . . does not add a new kind of deduction, but merely permits the inclusion of an additional element, namely obsolescence of such property. . .

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per se regulatory bar as regards the depreciability of "trade-names, trade-marks, trade brands, secret formulae or processes."

In its 1927 Treasury Decision 4055, respondent plainly stated that this statutory construction by the Eighth Circuit served as the backdrop for its change in the last sentence of the pertinent regulatory language. Upon review of the new and old sentences, *supra*, however, it is evident that all the Commissioner was trying to accomplish was to make clear in the regulation that the introduction of the phrase "including a reasonable allowance for obsolescence" did not add a new kind of deduction (e.g., for "loss" of an intangible asset on account of some act external to the business of the taxpayer) to the then existing statutory and regulatory language.

Viewed in this light, it is evident that respondent's contention that the rule regarding depreciation of goodwill changed in 1927 is simply wishful thinking. The necessary "limited" useful life characteristic of a depreciable intangible asset was unaffected by *Red Wing Malting* and no substantive change occurred in 1927 in the regulatory language.[7] As a matter of law, where a taxpayer is able to satisfy the limited useful life standard, depreciation has always been allowed.

Recently, Congress and respondent have acknowledged the severability of individual intangible assets from the general concept of "goodwill" and the nondepreciable nature (because it has no limited life) of residual goodwill. In enacting Internal Revenue Code §§ 338(b)(5) and 1060,

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[7] This Court reached the same result as in *Red Wing Malting* in another Prohibition-caused obsolescence, or loss, of goodwill case, *Clarke v. Haberle Crystal Springs Brewing Company*, 280 U.S. 384 (1930). The Court stated (*Id.*, at 386-87):

> . . . Congress cannot be taken to have intended such a partial compensation to be provided for by the words 'exhaustion' or 'obsolescence.' Neither word is apt to describe termination by law as an evil of a business otherwise flourishing. . . .

Congress recognized the distinction between nondepreciable goodwill which is a Class IV residual asset and other, severable depreciable Class III intangible assets. Importantly, no reference was made in these statutory enactments to the impact of continued patronage upon the "separate" nature of any distinct Class III intangible asset. Respondent itself has followed this "Class III-Class IV" thematic distinction in its regulations.[8]

In sum, the statutory and regulatory approach to the depreciability of intangible assets has been simple and straightforward. As a matter of law, if a taxpayer can establish that a particular intangible asset has a limited useful life, depreciation has always been allowed.[9] Thus, properly defined and considered in the context of respondent's long-standing regulatory and Congress' historical and newly enacted statutory approach to this issue, a depreciable intangible asset is easily distinguished from residual goodwill by the existence, *vel non*, of a limited useful life.

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[8] See Treas. Reg. § 1.338(b)-2T(b)(2) and § 1.1060-1T(d)(2) where intangible assets are designated as "Class III" assets and goodwill is designated as a residual "Class IV" asset. That Congress and the Treasury would make this distinction seriously undermines respondent's and the Third Circuit's positions.

[9] In *Northern Natural Gas Co. v. O'Malley, supra*, 277 F.2d at 139, then Judge Blackmun wrote in his concurring opinion that if a taxpayer can show that an asset is a wasting one, an allowance for depreciation must be allowed. This language was cited favorably in *Houston Chronicle, supra*, 481 F.2d at 1251.

C. A Number of Circuits Have Recognized the Indeterminate Useful Life Distinction

The Fifth, Seventh, Eighth, Ninth, Eleventh and Federal Circuits and the Tax Court have recognized the importance of the limited useful life distinction and have determined, as a matter of law, that depreciable intangible assets can be segregated from nondepreciable goodwill in the purchase of an ongoing business.[10] To resolve the conflict between these circuits and the Third Circuit it is essential to focus upon the application of the limited useful life requirement by the various courts rather than upon their definitional attempts. The limited useful life requirement has existed in the relevant regulation since before *Red Wing Malting, supra,* and Treasury Decision 4055. No overlay, relating to continued patronage, has ever served, as a matter of law, as a separate distinguishing characteristic between depreciable and nondepreciable intangible assets.

The confusion about what the term "goodwill" has meant in a similar tax circumstance was discussed in *Richard S. Miller & Sons, Inc. v. United States, supra*, 537 F.2d at 450-452. *Miller* was a "limited useful life" case involving insurance contract expirations. The Court of Claims held in *Miller* that if the useful life of an intangible asset could be shown to be of limited duration, and hence a "wasting asset," it would be considered to be an asset separate and

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[10] *Houston Chronicle*, (5th Cir.); *Laird v. United States*, (5th Cir.); *Super Food Services, Inc. v. United States*, (7th Cir.); *Donrey, Inc. v. United States*, (8th Cir.); *Commissioner v. Seaboard Finance Co.*, (9th Cir.); *Citizens & Southern Corp. v. Commissioner*, (11th Cir.); *Richard S. Miller & Sons, Inc. v. United States*, (Ct. Cl.); *IT&S of Iowa, Inc. v. Commissioner*, 97 T.C. 496 (1991); and *Peoples Bancorporation v. Commissioner*, T.C. Memo. 1992-285.

distinct from "goodwill" and, therefore, depreciable.[11] The Court held (537 F.2d at 454, 455):

> An intangible asset is separate and distinct from goodwill when its useful life can be shown with reasonable accuracy to be of *limited* duration. (Emphasis added.)
>
> * * *
>
> *The Treasury regulations permit depreciation of an intangible asset when the knowledge of its limited useful life can be shown 'from experience or other factors'.* 'Useful life' for depreciation purposes is an estimate, and the length of the useful period must be shown by evidence that allows it to 'be estimated with reasonable accuracy.' *The law does not demand '[e]xtreme exactitude in ascertaining the duration of an asset.'* The appropriate test is whether the particular taxpayer adequately has demonstrated that, in his business, the useful life of the challenged intangible reasonably may be approximated. (Emphasis added; footnotes omitted.)

In its opinion in this matter, the Third Circuit quoted from *Miller* regarding various meanings of the term "goodwill" (Pet. App. at 20a), but ignored the Court of Claims' holding, which relied on the language of Treas. Reg. §1.167(a)-3, *supra*, in distinguishing between depreciable

[11] In *Miller*, the Court held (537 F.2d at 452):

> At the threshold, plaintiffs must show that the 1,383 Arch insurance expirations are separate and distinct from the goodwill that was transferred in the sale. The most significant indication that an intangible asset is separate and distinct from goodwill is whether its useful life can be shown with reasonable accuracy to be of *limited* duration. The most important criterion is whether in fact it is a *wasting asset*. (Emphasis added.)

intangible assets having a limited useful life and nondepreciable goodwill. The Third Circuit held that petitioner had not satisfied its burden of demonstrating that its paid subscribers were *"separate and distinct from goodwill,"* even though petitioner's paid subscribers were found to be a separately identifiable asset with a limited useful life and an ascertainable value. Indeed, the Third Circuit's conclusion flies in the face of the applicable regulatory language. The court stated (Pet. App. at 28a-29a):

> . . . there are some intangible assets which, notwithstanding that they have wasting lives that can be estimated with reasonable accuracy and ascertainable values, are nonetheless goodwill and nondepreciable.

Since, as indicated in Part I of this brief, no distinction has been made throughout the history of the Code and the regulations between the depreciability of tangible and intangible assets—each must have a limited useful life and an ascertainable value—the Third Circuit's reasoning crashes to the ground when applied, as it also logically must be, to tangible assets.

The choice which the Third Circuit apparently made to rely on the earlier, non-specific judicial definitions of goodwill, instead of the Code and regulations was improper. Its reliance upon the "separate and distinct" language to reach its conclusion was equally misplaced. This language is not found in the applicable statute[12] or Treasury Regulation.[13] While the "separate and distinct" language apparently had its origin in early case law,[14] its application there suggests that even in 1926, the Eighth Circuit correctly distinguished

[12] See footnote 4, *supra*.

[13] Treas. Reg. §1.167(a)-3, at p. 8, *supra*.

[14] *Red Wing Malting Co. v. Willcuts, supra*, 15 F.2d at 633.

nondepreciable goodwill from depreciable intangible assets having a limited life which may be sold "separate and apart" from an established, ongoing business. Such a depreciable intangible asset as an acquired subscribers group is also an asset which can be used in a business to attract other sales (*i.e.*, advertising).

At this juncture in its opinion, the Third Circuit discussed a series of cases most of which were decided before the Fifth Circuit's landmark decision in *Houston Chronicle Publishing Co. v. United States, supra*, and the Commissioner's confirmation of the correctness of this holding in its own *Rev. Rul.* 74-456, 1974-2 C.B. 65 (where the Commissioner modified its previous rulings "to remove any implication that customer and subscription lists . . . are, as a matter of law, indistinguishable from goodwill possessing no determinable useful life.") The Court focused on language from these cases which described goodwill as the expectancy that old customers will return to the old place without contractual compulsion. (See Pet. App. at 23a-25a.) In so doing, it ignored the rule of law, confirmed in the applicable Code and regulatory provisions noted above, that if a taxpayer can establish that an intangible asset has a limited useful life and an ascertainable value,[15] a depreciation deduction is allowa-

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. . . good will has no existence *separate and apart* from an established business. With the termination of that business it is ended. While a capital asset, it is not the subject of purchase, sale, or assignment separate from the business itself. It is not an assignable asset distinct from the business. It is different in this respect from such intangibles as patents, contracts or franchises which may be sold. (Emphasis added.)

[15] The ascertainable value standard is the second relevant criteria for the depreciation of an intangible asset. Such a standard, however, is easier to satisfy than the limited useful life standard. The bias in the tax law is that practically all assets are susceptible to valuation. *United States v. Davis*, 370 U.S. 65, 72-73 (1962).

ble. Nowhere in the current precedent is there any support for the Third Circuit's conclusion that an intangible asset, having an ascertainable value and a limited life, cannot be depreciated because it is inextricably interwoven with the general goodwill of the business. The Circuits have almost universally held that the intangible value of a business is severable for tax purposes into its identifiable constituent parts.[16]

When the Third Circuit relied upon *Houston Chronicle, supra*, to support its unseverable goodwill conclusion (Pet. App. at 16a), it erroneously overexaggerated the importance of the "separate and distinct" language. Viewed in the context of the holdings in *Red Wing Malting, Miller*, and the decisions of the other Circuits, *supra*, all that the "separate and distinct" language recognizes is that an asset having no ascertainable useful life is nondepreciable goodwill, but that an intangible asset, for which a taxpayer can demonstrate a limited useful life, is depreciable.

This is exactly what the Fifth Circuit held in *Houston Chronicle*. When that court referred to the acquired Houston Press subscription lists as having "an ascertainable value separate and distinct from goodwill" it was referring to "goodwill" in the way that term is used in Treasury Regulation § 1.167(a)-3 (depreciable intangible assets with limited useful lives are separate and distinct from nondepreciable residual *goodwill*). This conclusion is compelled by the Fifth Circuit's additional holding in *Houston Chronicle* (481 F.2d at 1253):

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[16] See footnote 1, *supra*.

> We reject, however, the establishment of a *per se* rule and a monolithic 'mass asset' theory that would amalgamate all subscriptions lists with goodwill.

The Fifth Circuit's holding is further support for taxpayer here since that Court determined that, as a matter of law, if a taxpayer can show that an intangible asset has a limited useful life, such asset is depreciable.

The Third Circuit's reliance upon *Houston Chronicle* for its "separate and distinct" test was misplaced. Houston Chronicle was able to carry its burden of proof that it had acquired an amortizable intangible asset with a limited useful life and an ascertainable value by introducing the following proof (*Houston Chronicle, supra,* 481 F.2d at 1253):

— testimony from taxpayer's officers and employees, based upon their experience as publishers of an afternoon newspaper in the Houston area, regarding the cost of obtaining new subscriptions;

— corroborative testimony from the valuation engineers, based upon their study, discussed supra;

— testimony from taxpayer's officers and employees, again based on their experience, regarding the anticipated useful life of a subscription list used in connection with the publication of an afternoon newspaper in the Houston area;

— corroborative testimony from the valuation engineers, again based upon their study; and

— the results of a survey of *The Houston Chronicle's* current subscribers regarding the useful life of an average subscription, and testimony connecting the survey with *The Houston Press* subscription lists, i.e., testimony that conditions in the afternoon newspaper market in the Houston area had not been materially altered during the years in question.

Similar proof was introduced by petitioner and found by the District Court in this case. (Pet. App. at 33a, *et seq.*)

Respondent's argument that *Houston Chronicle* should be limited to the circumstance where only an amortizable intangible asset and not an ongoing business and its attendant intangible assets are acquired is incorrect. First, the very fact that such intangible assets as customer lists can be freely traded in the market confirms that these assets have a determinable fair market value.[17] Second, the fact that in *Houston Chronicle,* the District Court jury verdict found that in addition to the list of subscribers worth $71,200, the other intangible assets acquired included nondepreciable goodwill worth $775,400 and a covenant not to compete worth $1,809,400 demonstrates that the valuation there was done in the context of an ongoing business. Third, even in its own practices, respondent has agreed with the holding in *Houston Chronicle*[18] and acquiesced in another single asset transfer case, *Manhattan Company of Virginia, Inc. v. Commissioner,* 50 T.C. 78 (1968), government's appeal dismissed (*nolle pros.*), acq., 1974-2 C.B. 3.[19] Fourth, respondent has even acquiesced in cases where the deprecia-

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[17] See *Houston Chronicle, supra,* 481 F.2d at 1253, where the Fifth Circuit recognized that customer lists "are bartered and sold as discrete vendible assets." See also Treas. Reg. §20.2031-1(b) (definition of fair market value); and *United States v. Cartwright,* 411 U.S. 546, 551 (1973).

[18] See *Rev. Rul.* 74-456, *supra.*

[19] 1974-2 C.B. 1: "Acquiescence in a decision means acceptance by the Service of the conclusion reached . . . (but) not necessarily . . . acceptance and approval of any or all of the reasons assigned by the Court for its conclusions."

ble intangible asset was part of an ongoing business and the assets transferred included goodwill.[20] Respondent's acquiescences are inconsistent with the contention that the decisions in *Houston Chronicle* and *Manhattan Company* only permit depreciation of an intangible asset when such an asset is transferred separate from an ongoing business.[21] Respondent's reading of *Houston Chronicle* also ignores the subsequent opinion of the Fifth Circuit in *Laird, supra.* There, the Fifth Circuit extended its *Houston Chronicle* holding to the acquisition of a business having a number of intangible assets. The Court held, "(t)hat the assets contribute value to one another does not prevent their severability for tax purposes." *Laird*, 556 F.2d at 1234.

II
THE THIRD CIRCUIT'S PHALANX OF CASES ARE MERELY YESTERDAY'S WARRIORS

In its opinion, the Third Circuit refers to a " 'phalanx of cases' that have considered the definition and application of the term goodwill in the context of Treas. Reg. § 1.167(a)-3. . . ." (Pet. App. at 23a-25a.) Though these cases are noteworthy for their attempts to define "goodwill," the

[20] *Los Angeles Central Animal Hospital v. Commissioner, supra; Computing & Software, Inc. v. Commissioner,* 64 T.C. 223, 235 (1975), acq., 1976-2 C.B. 1; and *First Pennsylvania Banking & Trust Co. v. Commissioner,* 56 T.C. 677 (1971), acq., 1972-1 C.B. 2.

[21] Respondent's acquiescences are seemingly on a par with its issuance of Private Letter Rulings. While neither is precedential, *per se,* both are examples of respondent's practices in considering such transactions. Numerous taxpayers relied upon respondent's stated practices. *Rowan Cos. v. United States,* 452 U.S. 247, 261, footnote 17 (1981).

Third Circuit erroneously concluded that they also support respondent's position in this case. Merely because a court has defined goodwill in a broad or narrow sense does not mean that the court has also concluded that a separate, depreciable intangible asset cannot be found in the assets of an acquired ongoing business or that respondent has not previously agreed with this legal conclusion.[22] Even more importantly, the cases relied upon by the Third Circuit for a general definition of goodwill are no longer the most recent precedential pronouncements from the various circuits on the issue of whether a depreciation deduction may be allowed with respect to paid subscribers and other similar intangible assets. Though the Court refers to a number of cases from a number of circuits (Pet. App. at 23a-25a), these cases are no longer the law in those circuits.[23]

The Third Circuit cites *Boe v. Commissioner, supra,* but that case has been effectively overruled by *Commissioner v. Seaboard Finance, supra.* The court also cites *Nelson Weaver Realty Co. v. Commissioner,* 307 F.2d 897, 901 (5th Cir. 1962), *Commissioner v. Killian,* 314 F.2d 852, 855 (5th Cir. 1963), *Balthrope v. Commissioner,* 356 F.2d 28 (5th Cir. 1966), and *Winn-Dixie Montgomery, Inc. v. United States,* 444 F.2d 677 (5th Cir. 1971), but these cases were effectively overruled in *Houston Chronicle* and *Laird, supra.*

Though the Fifth Circuit acknowledged in *Houston Chronicle* that its earlier decisions included discussions of "goodwill," it also held that "(n)one of the foregoing cases supports the government's argument that subscription lists

[22] See, *e.g., Commissioner v. Seaboard Finance Co.;* See also *Computing & Software, Inc.;* and *Los Angeles Central Animal Hospital, supra,* where respondent acquiesced in the trial court's holding and did not file an appeal.

[23] See cases cited in footnote 1, *supra.*

are non-amortizable as a matter of law." (*Id.*, 481 F.2d at 1248.) In *Laird, supra,* the Fifth Circuit was even more explicit (quoting from *Griswold v. Commissioner,* 400 F.2d 427, 433 (5th Cir. 1968):

> The property, to be depreciable, must be an inherently wasting asset, but this allowance is not limited to tangible assets.

Clearly, a limited useful life is the key to depreciability whether the asset be tangible or intangible. No additional explicit or implicit statutory or regulatory hurdle exists which prevents a court from applying the correct rule of law: a taxpayer must establish that an intangible asset has a limited useful life and an ascertainable value in order for depreciation to be allowable with respect to that asset.

III

THE DISTRICT COURT'S "GALAXY OF CUSTOMERS" DESCRIPTION PROVIDES A BRIGHT-LINE TEST TO DISTINGUISH BETWEEN A DEPRECIABLE INTANGIBLE ASSET AND NONDEPRECIABLE GOODWILL

The District Court found that taxpayer presented substantial uncontroverted proof about its subscribers and their past subscription practices. The Court held that in identifying a separate, depreciable intangible asset, it was necessary to (Pet. App. at 32a-33a):

> distinguish between a galaxy of customers who may or may not return, whose frequency is unknown, and whose quantity and future purchases cannot be predicted, against subscribers who can be predicted to purchase the same item, for the same price on a daily basis.

In so finding, the District Court provided the Court, the respondent and taxpayers with a "bright-line" test to distinguish depreciable customer-based intangible assets from residual nondepreciable goodwill. Ordinarily, newspaper and magazine publishers know their subscribers' history. These subscribers' behavior is statistically predictable and the value of this intangible asset can be determined using appraisal methods commonly chosen in everyday business circumstances. As a result, publishers are capable of satisfying the two-pronged test set forth in Treas. Reg. § 1.167(a)-3. By contrast, those customers who select a newspaper or a magazine from a newsstand and pay cash are properly part of the "galaxy of customers" and a publication's residual goodwill. So too are the cash-only customers of a fast food restaurant or other similar enterprise—they show up at the counter one day, but no one knows whether they will return tomorrow.

In sum, two "bright-line" tests are available to be applied in this circumstance. The first, which the Third Circuit applied ignores the Code, as well as the Commissioner's regulatory and interpretive pronouncements and mandates that a new concept, "continued patronage," must be added—or substituted for—the limited useful life rule included in the regulations.

The second bright-line test, by contrast, is the correct, historical, regulatory rule of law that requires that a taxpayer establish that the intangible asset at issue have a limited useful life. Courts have always been comfortable applying this bright-line test and not all decisions have favored taxpayers.[24] As the Court has recently stated *(Quill Corpo-*

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[24] See, *e.g.*, the cases cited in footnotes 2 and 3. See also the now-overruled cases cited in the opinion of the Third Circuit. Pet. App. at 23a-25a.

ration v. North Dakota, No. 91-194, 1992 U.S. Lexis 3123, 3131, 60 U.S.L.W. 4423, 4427 (May 26, 1992): "Th[e] artificiality [of a bright-line test] is more than offset by the benefits of a clear rule." Unlike the circumstance in *Quill,* there is no artificiality to the Commissioner's interpretative regulations. The "limited useful life" rule of law was established many years ago. The only thing that has changed in the interim is a taxpayer's ability to satisfy the factual test inherent in that rule. The Commissioner's effort to add a new Sisyphean element to its regulatory rule of law—so as to stave off factual proof made possible by the computer age—should be rejected.

CONCLUSION

The decision of the Third Circuit misperceives the applicable statutory and regulatory provisions and disrupts the application of a consistent legal standard in the decisions of the various circuits. The long-standing rule of law regarding the depreciability of intangible assets requires a taxpayer to establish that an intangible asset has a limited useful life and an ascertainable value. These are questions of fact to be determined based upon historical evidence. The Third Circuit's decision is at odds with the precedent in a number of circuits, is wrong as a matter of law and unfairly reallocates the economic bases underlying many recent transactions. The Court should reverse the decision of the Third Circuit.

Respectfully submitted,

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